

**RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS**

**Financial Statements for the
Years Ended November 30, 2012 and 2011
and Independent Auditors' Report**

RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS

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INDEPENDENT AUDITORS' REPORT

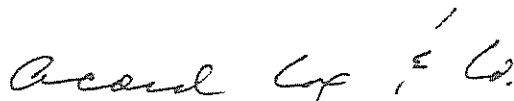
Board of Directors and Members
Rural Water District No. 2
Miami County, Kansas

We have audited the accompanying statements of net assets of Rural Water District No. 2, Miami County, Kansas as of November 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rural Water District No. 2, Miami County, Kansas as of November 30, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles in the United States of America.

The management discussion and analysis on pages 2 through 4 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



December 18, 2012

**Rural Water District No. 2
Miami County, Kansas**

Management's Discussion and Analysis

This section of the Rural Water District No. 2, Miami County, Kansas annual financial report presents an analysis of the District's financial performance during the years ended November 30, 2012 and 2011. This information is prepared and presented in conjunction with the annual audited financial reports prepared by the District's independent auditing firm.

Rural Water District No. 2 Financial Overview for 2012

- The District's total assets increased by \$701,576 from \$21,455,630 in 2011 to \$22,157,206 in 2012.
- The District's revenues from water sales increased by \$254,899 from \$2,637,041 in 2011 to \$2,891,940 in 2012
- The District's costs and operating expenses increased by \$97,975 from \$2,270,502 in 2011 to \$2,368,477 in 2012.
- The District completed pump upgrade at the Louisburg Booster Pump Station. This upgrade increases the flow to the Louisburg service area by 150 gallons per minute.

Overview of the Financial Statements

This report will include Management's Discussion and Analysis, Financial Statements for the years ended November 30, 2012 and 2011, along with the Independent Auditors' Report. The Independent Auditors' Report will include notes and supporting details for information presented in Management's Discussion and Analysis.

Required Financial Statements

The Financial Statements of the District report information by using accrual accounting practices. The Financial Statements conform to accounting principles that are generally accepted in the United States of America. The Statements of Net Assets include information on the District's assets and liabilities and provide information about the type and amounts of investments (assets) secured and the obligations to the District's creditors (liabilities). The Statements of Activities and Changes in Net Assets exhibit the District's revenues and expenses for the years ended November 30, 2012 and 2011. The Statements of Cash Flows present information on the District's cash receipts, cash payments and changes in cash flow resulting from operations, investments and financing activities.

Financial Analysis of the District

The Statements of Net Assets and the Statements of Activities and Changes in Net Assets present information on the District's financial condition. The District's net assets are indicated by the difference between its assets and liabilities. An improvement in the District's financial condition is reflected in its increase of net assets.

Net Assets

A summary of the District's Statements of Net Assets is presented below.

Table 1
Condensed Statements of Net Assets

	2012	2011	Dollar Change	Percent Change
Current Assets	5,064,203	3,592,985	1,471,218	40.9%
Noncurrent Assets	1,459,124	1,740,954	(281,830)	-16.2%
Capital Assets, net	15,633,879	16,121,691	(487,812)	-3.0%
Total Assets	22,157,206	21,455,630	701,576	3.3%
Current Liabilities	179,548	181,578	(2,030)	-1.1%
Total Liabilities	179,548	181,578	(2,030)	-1.1%
Net assets invested in				
capital assets, net of related debt	15,633,879	16,121,692	(487,813)	-3.0%
Unrestricted	6,343,779	5,152,360	1,191,419	23.1%
Total Net Assets	21,977,658	21,274,052	703,606	3.3%

Total assets increased by \$701,576 from \$21,455,630 in 2011 to \$22,157,206 in 2012. This is a result of increases in cash accounts. Capital assets are a net result of all fixed assets, including 2012 additions, less accumulated depreciation.

Total liabilities decreased by \$2,030 from \$181,578 in 2011 to \$179,548 in 2012. The District continued to see a reduced number of line extension deposits and advanced benefit unit payments.

Total net assets increased by \$703,606 from \$21,274,052 in 2011 to \$21,977,658 in 2012.

Table 2
Condensed Statements of Activities and Changes in Net Assets

	2012	2011	Dollar Change	Percent Change
Operating Revenues	2,891,940	2,637,041	254,899	9.7%
Non-operating Revenues	48,224	46,782	1,442	3.1%
Total Revenues	2,940,164	2,683,823	256,341	9.6%
Depreciation Expense	689,971	685,407	4,564	0.7%
Other Operating Expense	1,678,506	1,585,095	93,411	5.9%
Total Expenses	2,368,477	2,270,502	97,975	4.3%
Income Before Capital Contributions	571,687	413,321	158,366	38.3%
Capital Contributions	131,919	147,400	(15,481)	-10.5%
Changes in Net Assets	703,606	560,721	142,885	25.5%
Beginning Net Assets	21,274,052	20,713,331	560,721	2.7%
Total Net Assets	21,977,658	21,274,052	703,606	3.3%

The Statements of Activities and Changes in Net Assets represent revenue and expense items that affect the change in net assets. As the information presented in Table 2 shows, income before capital contributions was \$571,687 with capital contributions of \$131,919, which resulted in a net increase in net assets of \$703,606 for the year ended November 30, 2012.

The District's total operating revenues increased by \$254,899 from \$2,637,041 in 2011 to \$2,891,940 in 2012. Total operating expenses increased by \$97,975 from \$2,270,502 in 2011 to \$2,368,477 in 2012. The major contributors to the increase in expenses were related to plant expense and line maintenance expense.

Additional Financial Information

This financial report is designed to provide the District's patrons, investors and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact Rural Water District No. 2, Miami County, KS Business Manager at P. O. Box 186, Hillsdale, KS 66036.

RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS

STATEMENTS OF NET ASSETS
NOVEMBER 30, 2012 AND 2011

ASSETS	2012	2011
CURRENT ASSETS		
Cash	\$ 4,402,004	\$ 2,527,988
Certificates of deposit	309,293	734,922
Accounts receivable	156,721	164,109
Accounts receivable - wholesale	73,093	47,955
Interest receivable	805	1,982
Prepaid expenses	14,510	11,983
Inventory	107,777	104,046
Total current assets	5,064,203	3,592,985
NONCURRENT ASSETS		
Funds designated for capital improvement	1,459,124	1,740,954
Total noncurrent assets	1,459,124	1,740,954
CAPITAL ASSETS		
Nondepreciable capital assets	733,921	809,589
Depreciable capital assets	26,471,618	26,193,791
Less accumulated depreciation	(11,571,660)	(10,881,689)
Depreciable capital assets, net	14,899,958	15,312,102
Total capital assets, net	15,633,879	16,121,691
Total assets	22,157,206	21,455,630
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable	47,996	80,715
Other accrued liabilities	75,202	61,843
Line extension deposit	31,350	27,020
Advance benefit unit payments	25,000	12,000
Total current liabilities	179,548	181,578
NET ASSETS		
Invested in capital assets, net of related debt	15,633,879	16,121,692
Unrestricted	6,343,779	5,152,360
Total net assets	\$ 21,977,658	\$ 21,274,052

RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

	2012	2011
WATER SALES	\$ 2,891,940	\$ 2,637,041
COSTS AND OPERATING EXPENSES:		
Personnel costs	621,549	589,015
Depreciation and amortization	689,971	685,407
Chemical expense	177,139	168,349
Plant expense	142,300	128,800
Line maintenance	83,916	68,455
Water purchased	101,141	83,895
Water samples	5,009	1,344
Sales and use tax	3,568	3,510
Utilities	249,721	231,042
Contract meter reading	62,369	62,079
Professional services	20,377	45,658
Vehicle upkeep	72,775	68,027
Office supplies	51,936	56,783
Insurance	26,153	28,725
Tower maintenance	1,288	3,709
Dues	20,187	10,302
Miscellaneous	16,580	17,088
Water plan tax	11,049	9,305
Bad debts	1,091	667
Clean drinking water fee	10,358	8,342
	<u>2,368,477</u>	<u>2,270,502</u>
INCOME FROM OPERATIONS	<u>523,463</u>	<u>366,539</u>
NON-OPERATING REVENUES:		
Interest income	47,224	46,782
Gain on sale of fixed assets	1,000	-
	<u>48,224</u>	<u>46,782</u>
INCOME BEFORE CONTRIBUTIONS	571,687	413,321
CONTRIBUTIONS - BENEFIT UNITS AND AID-IN CONSTRUCTION	<u>131,919</u>	<u>147,400</u>
INCREASE IN NET ASSETS	703,606	560,721
NET ASSETS, BEGINNING OF YEAR	<u>21,274,052</u>	<u>20,713,331</u>
NET ASSETS, END OF YEAR	<u>\$ 21,977,658</u>	<u>\$ 21,274,052</u>

RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

	2012	2011
OPERATING ACTIVITIES:		
Cash receipts from customers	\$ 2,891,520	\$ 2,579,195
Cash payments to suppliers for goods and services	(1,703,947)	(1,565,847)
Net cash provided by operating activities	<u>1,187,573</u>	<u>1,013,348</u>
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from sale of fixed asset	1,000	-
Additions to capital assets	(201,159)	(156,202)
Contributions - Benefit units and aid-in construction	<u>131,919</u>	<u>147,400</u>
Net cash used in capital and related financing activities	<u>(68,240)</u>	<u>(8,802)</u>
INVESTING ACTIVITIES:		
Change in certificates of deposit	707,459	459,751
Interest received	<u>47,224</u>	<u>46,782</u>
Net cash provided by investing activities	<u>754,683</u>	<u>506,533</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,874,016	1,511,079
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>2,527,988</u>	<u>1,016,909</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 4,402,004</u>	<u>\$ 2,527,988</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income	\$ 523,463	\$ 366,539
Adjustments to reconcile operating income		
to net cash provided by operating activities:		
Depreciation and amortization	689,971	685,407
Gain on sale of fixed assets	(1,000)	-
Changes in:		
Accounts receivable	(17,750)	(20,706)
Inventories	(3,731)	(9,689)
Prepaid expenses	(2,527)	(1,225)
Interest receivable	1,177	1,829
Other receivable	-	31,391
Accounts payable and accrued liabilities	(19,360)	(3,058)
Line extension deposits	4,330	(14,640)
Advanced benefit unit payments	<u>13,000</u>	<u>(22,500)</u>
Net cash provided by operating activities	<u>\$ 1,187,573</u>	<u>\$ 1,013,348</u>

RURAL WATER DISTRICT NO. 2

MIAMI COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED NOVEMBER 30, 2012 AND 2011

1. DESCRIPTION OF ENTITY

- a. Organization and Description of Operations – The Rural Water District (the “District”) was established as a tax exempt organization under the laws of the State of Kansas and is governed by an independent Board of Directors. Principal functions of the District include the acquisition, treatment and distribution of water to owners and occupants of land located within the district. Total customers at November 30, 2012 and 2011 were 3,621 and 3,600.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- a. Basis of Presentation and Accounting – The District’s financial statements are presented on the full accrual basis of accounting and conform to accounting principles generally accepted in the United States of America. The District has elected under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities That Use Proprietary Fund Accounting*, to apply applicable GASB pronouncements, including GASB Statement No. 34, as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board, or any Accounting Research Bulletins, unless these pronouncements conflict with or contradict GASB pronouncements.

The accounts of the District are organized on the basis of a proprietary fund type, specifically an enterprise fund. The activities of this fund are accounted for with a separate set of self-balancing accounts that comprise the District’s assets, liabilities, net assets, revenues and expenses.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operations are included in the statement of net assets. Net assets (i.e. total assets net of total liabilities) are segregated into invested capital assets, net of related debt; restricted for debt service; and unrestricted components.

Management of the District has made certain estimates and assumptions relating to the reporting of assets and liabilities and revenues and expenses to prepare these financial statements in conformity with generally accepted accounting principles. Actual results may differ from those estimates.

- b. Cash Equivalents – For purposes of the statements of cash flows the District considers all highly liquid debt investments having original maturities of three months or less to be cash equivalents.
- c. Inventories – Inventories consist primarily of meters, line maintenance material and chemicals. Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.
- d. Loan Issue Costs – Costs related to obtaining loans have been capitalized and are being amortized on a straight-line basis over the term of the corresponding loan.

- e. Capital Assets – The cost of additions to the District’s plant, distribution system and other assets with an estimated useful life in excess of two years are capitalized. Cost includes materials, outside services and if applicable, interest on borrowed funds to finance construction. The District did not capitalize interest during the fiscal year 2012. The cost and accumulated depreciation of property sold or retired is deducted from capital assets, and any profit or loss resulting from the disposal is credited or charged in the nonoperating section of the statement of revenues, expenses and changes in net assets.

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

- f. Income Taxes – The District is a quasi-governmental unit, not subject to federal or state income taxes.
- g. Capital Contributions – Transmission and distribution system assets contributed to the District are capitalized at the members’ costs, which approximate fair value, and recorded as capital contributions when received.
- h. Net Assets – Net assets comprise the various net earnings from operating income, nonoperating revenues and expenses, and capital contributions. Net assets are classified in the following three components:

Invested in Capital Assets, Net of Related Debt – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

Restricted – This component of net assets consists of constraints imposed by creditors (such as through debt covenants), grantors, contributors or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

3. CAPITAL ASSETS

Changes in capital assets were as follows:

	2010	Additions	Transfers/ Disposals	2011
Nondepreciable capital assets:				
Land and easements	82,511	172	-	82,683
Construction in progress	1,141,878	87,744	(502,716)	726,906
	<u>1,224,389</u>	<u>87,916</u>	<u>(502,716)</u>	<u>809,589</u>
Depreciable capital assets:				
Plant and intake	8,250,915	-	-	8,250,915
Towers and standpipe	1,047,195	-	-	1,047,195
Transmission and distribution	15,768,054	538,106	-	16,306,160
Pumps and motors	152,559	2,873	-	155,432
Office furniture and equipment	235,801	6,123	-	241,924
Vehicles	141,318	20,786	(13,813)	148,291
Equipment	40,760	3,114	-	43,874
	<u>25,636,602</u>	<u>571,002</u>	<u>(13,813)</u>	<u>26,193,791</u>
Less accumulated depreciation	<u>(10,210,095)</u>	<u>(685,407)</u>	<u>13,813</u>	<u>(10,881,689)</u>
Depreciable capital assets, net	<u>15,426,507</u>	<u>(114,405)</u>	<u>-</u>	<u>15,312,102</u>
Total capital assets, net	<u>16,650,896</u>	<u>(26,489)</u>	<u>-</u>	<u>16,121,691</u>

	2011	Additions	Transfers/ Disposals	2012
Nondepreciable capital assets:				
Land and easements	82,683	268	-	82,951
Construction in progress	726,906	114,616	(190,553)	650,969
	<u>809,589</u>	<u>114,884</u>	<u>(190,553)</u>	<u>733,920</u>
Depreciable capital assets:				
Plant and intake	8,250,915	-	-	8,250,915
Towers and standpipe	1,047,195	-	-	1,047,195
Transmission and distribution	16,306,160	185,689	-	16,491,849
Pumps and motors	155,432	8,345	-	163,777
Office furniture and equipment	241,924	5,166	-	247,090
Vehicles	148,291	70,290	-	218,581
Equipment	43,874	8,338	-	52,212
	<u>26,193,791</u>	<u>277,828</u>	<u>-</u>	<u>26,471,619</u>
Less accumulated depreciation	<u>(10,881,689)</u>	<u>(689,971)</u>	<u>-</u>	<u>(11,571,660)</u>
Depreciable capital assets, net	<u>15,312,102</u>	<u>(412,143)</u>	<u>-</u>	<u>14,899,959</u>
Total capital assets, net	<u>16,121,691</u>	<u>(297,259)</u>	<u>-</u>	<u>15,633,879</u>

4. CASH AND INVESTMENTS

Deposits – At November 30, 2012 and 2011, the District's deposits were covered by federal depository insurance or by collateral held by the District's agent in the District's name.

Investments – State statutes also authorize municipalities to invest general operating monies in direct obligations of the United States government or its agencies or in repurchase agreements if local financial institutions are not able to pay the average Treasury bill rate. All investments must be insured, registered or held by the municipality or its agent in the municipality's name.

The District's investments are categorized as either (1) insured, registered or securities held by the District or its agent in the District's name, (2) uninsured and unregistered for which the securities are held by the broker's or dealer's trust department or agent in the District's name (3) uninsured and unregistered for which the securities are held by the broker or dealer, or by its trust department or agent but not in the District's name. The District's investments at November 30, 2012 and 2011 are summarized below:

	2012		2011		Category
	Carrying Value	Market Value	Carrying Value	Market Value	
Investments:					
Certificates of Deposit	\$ 309,293	\$ 309,293	\$ 734,922	\$ 734,922	1
Funds Designated for Capital Improvement:					
Certificates of Deposit	\$ 1,459,124	\$ 1,459,124	\$ 1,740,954	\$ 1,740,954	1

5. LONG-TERM WATER SUPPLY CONTRACTS AND AGREEMENTS

In connection with the original construction of the water treatment plant, a long-term contract was entered into with RWD #7 of Johnson County to provide water to that district. In addition to paying monthly charges based upon actual water usage, RWD #7 also agreed to pay an amount equal to 8.63% of the District's Water System Revenue Bonds, Series 1993. In connection with the plant expansion and the retirement of the 1993 bonds, the District amended and restated the water supply contract with RWD #7. Under the amended contract RWD #7 agreed to pay an amount equal to 10.94% of the Series 1998 Bonds.

The District also received \$333,143 in 1999 from RWD #7 for their portion of the costs associated with establishing the 1998 Bond issue which was amortized to non-operating income over a ten-year period.

In March of 2006, the District amended the wholesale water contract with RWD #7 and contributed \$337,037 for capital costs related to the water treatment plant.

In January of 2000, the District entered into a 20-year water supply contract with Rural Water District No. 1 (Miami No. 1), Miami County, Kansas. Under the agreement, the District is required to sell water to Miami No. 1 at rates based on a formula defined in the agreement.

In July of 2000, the District entered into a 30-year water supply contract with Rural Water District No. 1 (Franklin No. 1), Franklin County, Kansas. Under the agreement, the District is required to sell water to Franklin No. 1 at rates based on a formula defined in the agreement.

In July of 2003, the District entered into a water distribution contract with the City of Spring Hill, Kansas (Spring Hill) and RWD #7. Simultaneous with the water distribution contract, the District entered into a 20-year water supply contract with Spring Hill. Under the agreement, the District is required to sell water (not to exceed one million gallons per day) to Spring Hill at rates based on a formula defined in the agreement.

In February of 2006, the District entered into a 20-year water supply contract with the City of Edgerton, Kansas (Edgerton). Under the agreement, the District is required to sell water (not to exceed 250,000 gallons per day) to Edgerton at rates based on a formula defined in the agreement. Either party may, without cause, terminate the contract as of the 10-year anniversary of the contract upon 24 months prior written notice to the other party.

6. PENSION PLAN

Substantially all of the District's employees participate in the Kansas Public Employees Retirement System ("System"), a multiple employer public employee retirement system. Total payroll for employees covered by the System was \$444,257 and \$426,422 in 2012 and 2011.

Employees are vested upon hire and are required by state statute to contribute 4% of their salary (6% for employees hired after July 1, 2009) to the System. The District is required by statute to contribute the remaining amounts using the full funding method, which funds current costs each year and past service liability over a 40-year period. The District's monthly contribution rates are defined by the State and ranged from 7.34% to 7.94% and 6.14% to 6.74% in 2012 and 2011. The contribution requirement for the years ended November 30, 2012 and 2011 was \$56,864 and \$52,665, which consisted of \$21,036 and \$20,924 from employees and \$35,828 and \$37,741 from the District.

The District has a 457 deferred compensation plan. Under the Plan the District matches employee contributions at rates from 2.50% to 4.50% depending upon years of service. For the years ended November 30, 2012 and 2011 the District's contribution to the Plan totaled \$16,436 and \$14,912.

7. ADVANCE BENEFIT UNIT PAYMENTS

Potential customers desiring water service within the District are required to submit an application for a benefit unit along with a deposit for the cost of a benefit unit. Such payments, refundable only if service cannot be provided, totaled \$25,000 and \$12,000 at November 30, 2012 and 2011.

8. RELATED PARTY TRANSACTIONS

A member of the Board of Directors is an affiliate of a company that was paid \$3,520 in 2012 for construction services.

9. COMPLIANCE WITH KANSAS STATUTES

References made herein to the statutes are not intended as interpretations of law, but are offered for consideration of the Director of Accounts and Reports and interpretation by the County Attorney and legal representatives of the Water District. There were no apparent statutory violations during the years ended November 30, 2012 and 2011.

10. SUBSEQUENT EVENTS

Management has evaluated subsequent events through December 18, 2012, the date which the financial statements were available for issue and determined there are no subsequent events required to be disclosed.

* * * * *